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SUBJECT: REINVENTING THE RUSSIAN DRUG STORE

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¶1. (SBU) SUMMARY: Much like Russia's booming pharmaceuticals market (Ref A), the Russian pharmacy business is rapidly expanding. Major Russian drug store chains are consolidating their market-leading positions, but the industry is still relatively unconcentrated, with the leading drug store chain only accounting for a 6.5 percent market share. Observers expect the wave of consolidations to continue for years to come, and some believe a major European firm will enter the market soon. Small, independent drug stores and kiosks that are not computerized and not particularly concerned about customer service still remain, but we believe they will increasingly be swept aside by the bigger, savvier chains. The industry is still evolving, and the jury is still out on the potential impact of changes in the drug store business on access to drugs and improved health and wellness for the average Russian. Even so, the rise of big drug store chains concerned about quality and their reputation holds some promise that Russians will increasingly have access to higher quality and more effective medicines. END SUMMARY.

Drug Store Market Sizzles

¶2. (U) Like the pharmaceuticals industry (Ref A), Russia's drug store sector is booming. While Russian pharmacy sales figures are not publicly available, the Russian market analysis firm DSM Group estimates that retail sales at drug stores during the first half of 2007 exceeded five billion dollars, a 23 percent increase over the same period in 2006. Russia's biggest drug store chains have been expanding at a feverish pace, but the market still remains relatively unconcentrated, with the largest drug store chain only controlling an estimated 6.5 percent of overall sales. Although Russian drug stores may once have been known for displaying products behind glass and Soviet-era customer service, the leading chains have adopted open, Western-style floor plans and carry more consumer products beyond basic medicines.

Big Chains on an Acquisition Tear

¶3. (U) Russia's largest drug store chain, "36.6" (the normal human body temperature in degrees Celsius), has rapidly expanded over the past year, mainly by acquiring over 350 existing drug stores from regional pharmacy chains. Using innovative financial mechanisms to bankroll its acquisitions (Ref A), 36.6 now boasts 1,100 drug stores across 26 regions, outstripping its nearest rival, Rigla, which owns 650 drug stores in 22 regions. The other major players are the Moscow Oblast Pharmacy chain (517 stores), Raduga (455 stores), and Doctor Stoletov (420 stores). 36.6's retail sales growth has risen 82.9 percent during the first nine months of 2007 compared to the same period in 2006. Russia's biggest drug store chain has been rated the Best Consumer Sector Company in Russia for two years in a row by Global Finance Magazine. The very biggest chains have a particularly strong position in Moscow. In a recent survey of Moscow consumers, 55 percent said they routinely bought medicines at 36.6, while 23 percent said they shopped at Rigla.

¶4. (U) The rapid growth of 36.6 is being mirrored by other top drugstore chains. Rigla became the second-largest pharmacy network in December 2006 after absorbing the Ozone drug store chain. Dr. Stoletov became the fifth-largest druggist following the January 2007 acquisition of the Efedra pharmacy chain in Saratov Oblast. Although other chains are smaller and less regionally diverse than 36.6 (Dr. Stoletov only has stores in 10 regions, as opposed to 36.6's coverage in 26 regions), they are also enjoying high sales growth. Dr. Stoletov, for example, had a 92 percent increase in sales during the first half of 2007 compared to the same period in 2006, according to market analysts.

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Consumer Goods Come to Russian Drug Store Shelves
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¶5. (SBU) One pharmaceutical industry representative told us that the recent tremendous growth in drug sales and the concomitant strong growth in fast moving consumer goods (e.g., toiletries, soaps,

cosmetics, toothpaste, shaving needs, and detergents) are both persuasive signs that Russians in the coming years will spend lots of money on both over-the-counter and prescription drugs. Naturally, drug stores have benefited from these overall trends in consumer buying. Pharmacies are realizing more profits from cosmetics and bathroom goods and expanding their marketing base beyond medicines. Although still a far cry from the broad range of goods and services offered at dominant American chains like CVS and Walgreens, the biggest Russian chains carry household and bathroom items, and cosmetics and perfumes. 36.6, for instance, is the exclusive Russian distributor of FCUK (French Connection United Kingdom) cosmetics and UK-based Early Learning Centre toys. The chain also produces its own private label bath products, including shampoo, facial care items, toothbrushes, and combs.

Will a Foreign Player Enter the Market?

¶6. (SBU) Observers expect the wave of acquisitions among Russian drug store chains to continue over the next few years. There was press speculation in the past few months that Rigla and Dr. Stoletov were engaged in serious merger discussions (their combination would create a network of drug stores almost as big as 36.6). Many analysts have also been expecting that a major Western European drug store or pharmaceutical company would enter the market, probably through the acquisition of one of the big Russian chains. Most of the speculation has centered on the German-based Celesio AG, which has openly expressed interest in acquiring Russian pharmacies, and UK-based Alliance Boots, which already owns a handful of Russian drug stores. (NOTE: The Finnish-based Tamro Group already has a significant minority stake in Raduga, Russia's fourth largest druggist. END NOTE.)

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Is There an Impact on Access to Drugs and on Wellness?

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¶7. (SBU) A senior health consultant at the Open Health Institute, one of Russia's leading health NGOs, told us it was a complex question whether the changes taking place in the pharmacy business are improving access to medicines or might ultimately lead to improvements in health. He noted that big drug store chains tend to have higher quality control standards, as they are generally more concerned about maintaining their commercial reputation than smaller pharmacies. Some big chains have tried to discourage consumers from shopping at smaller drug stores by implying that their medicines are safer and less likely to be counterfeited. He cautioned, however, that there was no real evidence about whether smaller, independent drug stores served as the major outlets for the significant volume of counterfeit drug sales in Russia (Ref A). Thus far, he had not seen any indication that competition among drug stores had lessened, or that big chains were colluding on prices or attempting to gouge consumers. In his view, many big drug stores chains carry the same range of medicines as independent pharmacies, including offering strong antibiotics over the counter that would only be available with a prescription in the United States. The big chains do, however, more actively sell dietary and nutritional supplements.

¶8. (SBU) As some chains have expanded, they have shifted to appealing to a more well-off customer base, raising questions about whether drug store consolidation has had an impact on improved access to medicines for less well-off customers. For example, Russia's fifth-largest druggist, Dr. Stoletov, started off as a more affordable pharmacy chain, but with its recent expansion, has shifted to selling more expensive drugs. Most big chains also do not distribute medicines under the government's free drug benefits program for veterans, pensioners and the chronically ill, which is known as the Additional Drug Supply or DLO (Refs B, C).

¶9. (SBU) COMMENT: The consolidations and acquisitions among Russia's drug stores are a sign of a modernizing industry that is doubly benefiting from the rapid growth in the overall pharmaceuticals market (Ref A) and in fast moving consumer goods, such as cosmetics, perfumes, and household and bathroom products. As the big chains keep expanding, we expect that the days are numbered for smaller, independently-owned and non-computerized drugs stores and kiosks. Although the industry is still evolving and the jury is still out on the potential impact on access to drugs and improved health, the rise of big drug store chains concerned about quality and their reputation does hold some promise that Russians will increasingly have access to higher quality and more effective medicines.

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